



Canadian Life
and Health Insurance
Association Inc.

Association canadienne
des compagnies d'assurances
de personnes inc.

September 30, 2013

Submitted to FSB via email

Financial Stability Board

Re: FSB Consultative Document - Principles for an Effective Risk Appetite Frameworks

The Canadian Life and Health Insurance Association Inc. ("CLHIA") is a voluntary trade association whose member companies account for 99 percent of Canada's life and health insurance business. Our industry provides a wide range of financial security products such as life insurance, annuities and supplementary health insurance to about 26 million Canadians.

The CLHIA welcomes the opportunity to provide input to the FSB in their development of principles for effective Risk Appetite Frameworks ("RAF").

General Comments

The Canadian life insurance industry agrees with the goals of the FSB to establish international principles for effective RAFs to facilitate effective risk management and governance practices and to contribute to efficient supervision.

The CLHIA would like to emphasize the importance of the application of the document to be principles based in practice. Specifically, it should be universally acknowledged that a RAF is another *internal* management tool that is tailored by the firm to its business strategy and corporate legal structure. The RAF should be the responsibility of the firm without supervisors intervening into business strategy and without requiring firms to provide rationale to supervisors for risk appetites the firm establishes. In particular, the linking of Risk Appetite Statements ("RAS") to strategic and capital and financial plans must be company specific.

The document should provide a basis for supervisors to rely upon the effective RAF as the primary tool to ensure a firm's financial stability. Supervision of a firm's RAF should generally obviate the need for alternative supervisory measures such as additional capital - increased capital requirements should be limited to warranted circumstances. Also, it is important to ensure the principles that a firm adopts for its risk appetite are consistent with regulatory requirements for ORSA and setting internal capital targets. It would very difficult for the industry to have to deal with two competing requirements for risk appetite from FSB principles and ORSA risk appetite requirements.

The CLHIA believes the proposals in the document for roles and responsibilities are overly prescriptive as currently drafted. It would be more appropriate for the document to place greater emphasis on the principle of ensuring there are effective processes in place to ensure roles and responsibilities are effectively set, including limiting duplication and ensuring there are no gaps.

I. Introduction

The CLHIA agrees with the FSB highlighting the importance of RAFs needing to be actionable and measurable, and reinforcing a strong risk culture. Further supporting our opinion in the previous section, we agree with the statement that the Principles are “high level to allow financial institutions to develop a RAF that is firm-specific and reflective of business models and the organization” and to enable financial institutions to be adaptable to the changing economic and regulatory environment. We also agree with the FSB’s goal to create common definitions.

II. Key definitions

The definition of Risk Capacity in the FSB Principles document should be amended to reflect regulatory requirements for internal capital targets to be based on internal assessments of capital needs as opposed to regulatory minimums. In order to comply with ORSA and other regulatory capital requirements, internally developed risk capital measures will have to form a key component of risk appetite at group and legal/regulated entity levels.

There are several terms used in the Roles and Responsibilities section which are not defined within Section II Key Definitions: “Risk Culture”, “Serious Breaches”, “Material Risk Limit Breaches”, “Forward Looking Assumptions” and “Prudent Risk Appetite”. A glossary would be helpful to include a set of more specific definitions.

Specifically, the introduction of the term “Prudent Risk Appetite” in the Roles and Responsibilities section adds a subjective judgment to what is described previously in the document as the firm’s accepted Risk Appetite. Does this imply there is an additional requirement to ensure that the risk appetite defined by the Board and senior management as acceptable should also be sufficiently “prudent”? If this is the case, additional qualification of the term “prudent” and its criteria are required.

III. Principles

(i) Risk Appetite Framework

In reference to 1.1(d) and 1.1(f) viewed together, the document should be more explicit that RAFs also facilitate organizations taking advantage of risk opportunities.

(ii) Risk Appetite Statement

The document should be more explicit to recognize concentration and diversification benefits.

(iii) Risk Limits

There should be some flexibility to set risk limits in accordance with how the financial institution is being managed. The wording of this section is very prescriptive and assumes the management of the financial institution follows a predefined structure: “For the purposes of risk appetite, risk limits are

the allocation of the firm’s aggregate risk appetite statement to business line, legal entity levels, specific risk categories, concentrations and as appropriate, other levels.”

The definition of risk limits addresses limits that are quantified. We recommend a broader definition to include qualitative aspects. Such risks can be monitored and managed – breaches are escalated for discussion on mitigation strategies.

We suggest the wording of 3.1(a) is not as clear as it could be. It implies a trial and error process in setting limits?

(iv) Roles and responsibilities

The CLHIA’s overall comments on this section are: (a) the roles and responsibilities are very detailed for what is meant to be a high level principles document; (b) there are significant overlaps in responsibilities; (c) the roles for the Board are too operational in some respects; and (d) the importance of the role of the CRO should be increased.

Significant overlap in responsibilities can lead to duplication and items “falling between the cracks”. An example of a significant overlap between CEO, CRO and CFO responsibilities is in relation to “prudent risk appetites” (the (a)’s in 4.2, 4.3 and 4.4). The document states the CEO “establishes” a prudent risk appetite, and both the CRO and CFO “develop” a prudent risk appetite, with both the CRO and CFO incorporating risk appetite into strategic, business and capital planning. Although this overlap of accountabilities illustrates the importance of the partnership between the CRO and CFO in terms of strategic planning, risk appetite and assessing capital adequacy, the document does not indicate who has the ultimate responsibility. Other examples of overlap exist within 4.3 and 4.4. Another example relates to quantification responsibilities – for example the CRO should be accountable to the Board for internally measured Risk Capital and the CFO should be accountable for measures of Available Capital. In our view, the CRO is ultimately responsible for RAF (and Risk Capital under ORSA) development, and the Board approves.

The document should place emphasis on the principle of establishing who has ultimate responsibility for specific aspects of the RAF, without necessarily getting prescriptive for who has ultimate responsibility for all specific aspects of the RAF.

With respect to the Board’s role, the CLHIA recommends the document condense Section 4.1 to concentrate on the principle of the Board ensuring processes, or as per 4.4(i), “mechanisms”, are in place to fulfill the Board’s general role of stewardship/oversight, not operational. Essentially, the Board is accountable for the development the RAF, however they will delegate responsibilities to senior management, such as discussion with supervisors on changes to the RAF (as compared to the Board having the responsibility of discussions with supervisors on the overall RAF), while retaining ultimate approval and oversight. All policies relating to the RAF will require board approval.

The CRO role as described does not reflect the importance of the CRO role as an integral part of the business framework that needs to be relied upon to derive risk management strategies. The CRO should be as involved as the CFO in ensuring that the risk appetite of the firm is aligned with its short and long-term strategies, business and capital plans, risk capacity, compensation programs, and with supervisory expectations.

Below are further comments on specific provisions

- Introduction – We believe it is not appropriate to describe the Board’s role as “establish” the RAF. The Board is accountable for the development the RAF, however they will delegate this responsibility to senior management as appropriate while retaining ultimate approval and oversight. A more appropriate description of “translate those **expectations**” would be “operationalize the RAF” (“into targets and constraints for...”).
- Section 4.1 – There are a number of instances of the use of the word “ensure”. These instances should be clarified to state the Board should satisfy itself there are processes in place to meet the (respective) requirements, otherwise it could be interpreted the Board has operational responsibilities.
- Sections 4.1(e) and 4.1(f) – These expectations should be based on the principle of “proportionality” (i.e. for both the “regularity” of reviews, and the timing and degree of action on “breaches”).
- Section 4.2 – As with the comment pertaining to the Board, in relation to the CEOs roles/responsibilities, we suggest alternative words for “establish” and “ensure”.
- Section 4.2(g) – The requirement to conduct on a “day to day basis” should be subject to the criteria of materiality. For example, while “day to day” is relevant for a trading operation, it is not appropriate for life insurance businesses.
- Sections 4.3(i), 4.4(e) and 4.5(g) – It is not clear why these sections are worded differently. If the slight differences in the words used are intended to convey different responsibilities, it is not obvious what they are supposed to be. Also, it would be far better to use the word "promptly" in those sections rather than "immediately". To require something to be done "immediately" sets a standard with which compliance is impossible. The word “promptly” is more consistent with the principle of proportionality.
- Section 4.4 (b) – We recognize that incorporation of risk appetite into compensation practices can be very challenging to achieve for many financial institutions, especially where it would imply significant changes to compensation schemes. However, it is difficult to argue that employee incentives, especially at the senior level, should not be influenced by whether the firm or business group/unit was able to manage risk within stated tolerance levels. Compensation should not be driven by performance that is achieved from taking risks that are outside of policyholder and shareholder tolerance. Ultimately the language around this requirement could be amended to reflect the practical difficulties of making significant changes to established compensation schemes.
- Section 4.6(a) and (c) – The frequencies should be subject to materiality considerations.
- Section 4.6(f) – The reporting of deficiencies should be limited to “significant” ones.

We trust our comments will provide useful insights to the FSB in finalizing this document. We would be pleased to discuss any aspects of this submission at your convenience.

Sincerely



Steven W. Easson, FCIA, FSA, CFA
Vice President and Chief Actuary
Canadian Life and Health Insurance Association Inc.